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Lender Not Entitled to Prepayment Charge: Loan Repaid Before Maturity, But Interest Paid to Term's End

In a recent case which stemmed from a refinancing wherein our firm represented the borrower, the important issue for the court was this: Whether the lender was entitled to receive a $36,671.08 prepayment penalty where the loan was repaid before maturity, but the interest was paid to the end of the mortgage term.

The borrower had purchased a property for $26.5 million, and arranged $3.5 million in mortgage financing with a lender. Prepayment was precluded for the first six months of the term, and was subject to stipulations thereafter. The mortgage maturity date was December 6, 2018.

In a short period leading up to November 22, 2018, which was two weeks before the maturity date, the borrower took steps to pay back all the principal and interest that would have been payable under the mortgage. In effect, the borrower was paying everything that the lender could expect to receive under the mortgage at maturity; it had merely made the needed payments two weeks earlier than that date.

However, the lender nonetheless sought to extract a prepayment charge of one months' interest, relying ostensibly on the mortgage's prepayment clause. The clause stated that: the borrower could repay the whole or any part of the principal outstanding plus interest accrued, upon giving at least one month's notice on any monthly payment date.

The crux of the parties' dispute was whether the borrower had indeed given notice, and triggered the clause. The correspondence between the parties' respective lawyers was pivotal on this issue. In a November 8, 2018 letter, the borrower's lawyer, David Markowitz of our firm, advised the lender's lawyer of the borrower's intent to payout the mortgage on or prior to maturity, and requested a discharge statement. A week later, on November 15, 2018, he wrote again to advise that the borrower was arranging new financing in time for a November 22, 2018 payout, and requested a discharge statement again.

The lender's lawyer did ultimately send it, but included the unanticipated prepayment charge; pointing to the November 15, 2018 letter as being tantamount to one-months' notice as of December 6, 2018 (being both the next payment date and the maturity date of the loan) and charging interest to January 6, 2019, for one month's pay in lieu of notice under the prepayment clause.

Although repayment of the mortgage was made on November 22, 2018, the borrower offered to pay interest to maturity, being December 6, 2018. As such, the disputed amount was $36,671.08 (being one-month's interest). On November 22, 2018, the borrower paid the disputed amount under protest, obtained registered discharges from the lender, and applied to the court for a determination.

The court began noting there were few Canadian court cases on the meaning of "prepayment" in the mortgage context, but it is often linked to a reduction in the amount of interest owed, with the lender being given advance notice so it has time to arrange for an alternate investment of its funds. Here, based on the mortgage's wording, the clause was intended to benefit the borrower, as a means of allowing it to save on interest over the remaining term of the mortgage.

The Court found that the borrower's payment on November 22, 2018 did constitute a breach of the mortgage, since it was technically a full mortgage repayment before the December 6, 2018 maturity date. However, the borrower's breach did not entitle the lender to charge a fee that was neither agreed-to, nor provided for in the mortgage. Plus, with the repayment being a mere two weeks early, the lender was unlikely to have suffered damages and provided no evidence to the Court of any damages suffered. It had been paid all the interest it could expect to receive under the mortgage agreement.

In the end, the court declined to award even nominal damages for the borrower's breach, and declared that the lender must repay the borrower for the $35,671.08 that was improperly charged. Further, the Court made a subsequent costs award, awarding the borrower costs of $60,000 as a result of its success in the proceedings. See: *2598508 Ontario Inc. v. 2394049 Ontario Inc. o/a Goodman Green Solutions*, 2021 ONSC 5293 (CanLII).

Failure to Give Discharge Statement Suspends Lender's Power of Sale

The borrower purchased a gas station for $5.4 million, and financed it with a $3.79 million mortgage. After the lender made a demand under the mortgage, the borrower entered into a highly-conditional agreement to re-sell the property for $8.7 million, with a February 2021 closing. It did so without telling the lender.

Soon after, the lender delivered a Notice of Sale, and started private power of sale proceedings. The 35-day statutory

standstill of proceedings expired on January 13, 2021. A day later, the lender first learned that the property was already sold by the borrower, who was now asking for a discharge statement. The lender didn't provide one at that point or at any time after, having (incorrectly) concluded that since the Notice of Sale period ended, the borrower's equity of redemption period had already expired. The lender listed the property for sale the next day.

Ultimately, this resulted in two conflicting, tandem sales of the same property to third parties: One by the borrower (for $5.4 million); and one by the lender (for $4.9 million, and heavily financed). The court was asked to decide which of the two putative sales was valid.

The court began by saying that "there is nothing untoward about the mortgagees listing the property for sale under their power of sale while the owner is trying to sell it and *vice versa*." Any lawful sale by the lender would preclude the borrower from interfering, and from redeeming the mortgage. Conversely, the borrower might sell before the lender does, in which case it can pay the mortgage in full, obtain a discharge, and provide clear title.

However, the lender was not entitled to opine on the "legitimacy" of the borrower's intended sale; it is simply required under s. 22(2) of the *Mortgages Act* ("Act") to provide the borrower with a discharge statement – which the lender in this case did not do. That failure engaged the provisions of s. 22(3) of the Act, which states that the lender's right to enforce the mortgage "shall be suspended" until it complies with its obligations under s. 22(2). Otherwise, a lender could essentially thwart the borrower's right to cure its default, by hiding the information the borrower needs.

Section 22 of the Act operates to protect the borrower's equity of redemption; it is not foreclosed by the expiry of the 35-day standstill period. That right to redeem lasts until the lender sells or agrees to sell the property, and enables the borrower to cure defaults despite anything in the mortgage to the contrary, or pay out the mortgage and keep the property. It is unaffected by the fact that power of sale proceedings are underway, or that Notice of Sale has been given.

Here, the lender had no objectively reasonable excuse not to deliver the discharge statement, despite its concerns over the borrower's relatively high sale price and conditional sale arrangements. The lender would be paid out in full regardless, and the borrower had the right to know how much it had to pay to redeem at any time prior to the lender selling.

The lender ignored the borrower's good faith request for the discharge statement at its own risk. Under the Act, its right to enforce the mortgage under the private power of sale had been suspended at the time of its sale to the third party, which meant the transaction was void. See: *2544176 Ontario Inc. v. 2394762 Ontario Inc.*, 2021 ONSC 3067 (CanLII).

Builder's Failure to Provide Tarion Documents: A "Technical Flaw"

The buyer and builder entered into an Agreement of Purchase and Sale ("APS") respecting the new construction of a $3.3 million, five-bedroom freehold luxury home in Toronto. The deal did not close, and the court was called in to resolve the parties' subsequent dispute as to which of them should bear liability.

The builder claimed the buyer had simply failed to close; as such she was in breach of the APS, had forfeited $493,606 in deposits, and was liable for the builder's additional damages.

The buyer claimed she had justly rescinded due to misrepresentation and unconscionability, and was entitled to have her deposit returned. She also contended that the Tarion-registered builder was not "ready, willing and able" to close because it had failed to conduct a Pre-Delivery Inspection (PDI) and supply various Tarion warranty documentation, including the Warranty and PDI Certificates.

The builder conceded it had not delivered these materials. However, it asserted that the law did not require it to "go through the motions" on completing the Tarion warranty obligations in the face of the buyer's clear intent to rescind. In the time leading up to the aborted closing on April 15, 2019, the builder's various notices to extend the initial closing date had been met with the buyer's blanket refusal to close on any date whatsoever. She never took further steps toward fulfilling her obligations under the APS, nor did she pay the balance of the purchase price.

The court agreed with the builder. In these particular circumstances, the non-delivery of the warranty-related documents and the lack of a PDI could not be treated as the *builder's* unwillingness to close. Rather, the *buyer* had already expressed she was unwilling to close, and never requested either the documents or the PDI.

After the builder properly rejected the buyer's repudiation, it was not required to have "perfection in its own performance leading to closing". Full compliance with the Tarion scheme is "not a condition of closing, and cannot be taken to mean, in and of itself, that the vendor is unwilling or unable to close." Rather, the warranties are simply designed to give comfort and confidence to buyers that post-closing defects in construction will be remedied.

The builder's steps towards closing were admittedly imperfect. However, this could be overlooked either as a "technical flaw," or on the basis that the builder "did not have to make meaningless or futile gestures" to demonstrate readiness to close. Not every breach under the Tarion legislation results in a contract being void or unenforceable.

After dismissing the buyer's claims of misrepresentation and unconscionability, the court ruled that she had wrongly refused to close, had repudiated the agreement and had forfeited the $493,606 in deposits – which, at 15 percent of the purchase price, was neither disproportionate nor unconscionable. The builder's application was granted, and the issue of damages was directed for a trial. See: *Grandfield Homes (Kenton) Ltd. v. Li*, 2021 ONSC 2670 (CanLII).